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# Strategic group mapping banking industry

### Strategic group mapping of banking industry.  What is strategic group mapping.  Strategy roles in banking.

Ofer Meilich's research aims to create a structured process for constructing and interpreting strategic groups maps. These visual tools help capture the competitive landscape in an industry, showing competition between and within groups, mobility barriers, available niches, positioning, and industry dynamics. The paper builds upon Michael Porter's original work by reviewing the past 40 years of research on strategic groups and combining practitioners' uncodified practices. The process involves five steps: defining the industry, identifying strategic characteristics, dividing firms into groups, selecting main map dimensions, and drawing the map. Specific instructions are provided for both academic researchers and practitioners. The paper also includes several examples of strategic groups maps and discusses ways to interpret them, as well as limitations and conclusions. In a separate example, Ofer Meilich notes that banking penetration is no longer the primary indicator of success in developed versus developing markets. He suggests considering multiple factors such as capital-market depth, growth outlook, asset mixes, margin trends, regulation, and risk when discussing growth opportunities. Digital attackers are likely to find established business models increasingly attractive due to emerging markets with high margins such as Latin America and China. However, these markets can be susceptible to abrupt turns in the credit cycle, making short-term investment bets complicated by volatile commodity prices and structural challenges like income inequality and political instability. In contrast, India is seeing growth in the number of bank accounts, despite only half the population having access to banking services. Western Europe's penetration rates are lower than those in the US, reflecting high-risk costs of corporate debt. Banks face pressure to improve efficiency by cutting operating costs and selling off bad loans to bolster their capital base. This may lead to a noticeable dip in net interest margin, settling at around 3% by 2025. However, investment banking fees are expected to grow due to M&A and issuance activities, while asset management fees could see an uptick. Lower interest rates could also lead to higher refinancing fees for banks. Noninterest income is estimated to increase to nearly 1.5% of average assets, based on Deloitte estimates. Banks will need to prioritize tech modernization and retaining high-quality talent, which may result in higher compensation expenses. Expense management will be a major priority, with the industry's average efficiency ratio hovering around 60% in 2025. Credit quality is expected to return to normal as banks focus on pulling the right levers to keep costs under control and pave the way for sustainable growth. Net charge-offs are expected to increase moderately in 2025 compared to 2024 levels. Despite lower interest rates potentially boosting mortgage demand, credit losses in consumer loans could become a concern. Delinquencies will likely rise in credit card and auto loans as consumers' financial situations deteriorate. Credit card loans have the highest delinquency rate at 1.69% and net charge-off rate at 4%. While these numbers are lower than those seen during the 2008 crisis, they're still a potential issue. The commercial real estate (CRE) sector remains distressed, particularly the office segment, which may impact regional banks' loan loss exposure. Some banks might choose to reduce their CRE asset exposure and reposition their balance sheets. As a result, the overall net charge-off rate is projected to reach 0.66% in 2025, the highest in a decade but still lower than during the 2008-2009 crisis. In 2025, diversified banks will likely benefit from multiple revenue streams. Large banks may reduce deposit rates in line with declining interest rates, which could provide them with a buffer to remain competitive. Midsize and regional banks might face increased competition when modifying deposit rates, while their cost of interest-bearing deposits remains high at 3.15%. Credit card companies could see an advantage from rising credit card loans, while other payments firms may experience modest or flat revenue growth but face the prospect of rising delinquencies. Banks focused on capital markets will likely perform better but with higher compensation expenses. Larger banks already have buffers to manage loan losses. Some midsize and regional banks might struggle due to concentrated exposures to sectors like office space real estate. In fact, banks with assets between $10 billion and $100 billion have the highest CRE loans as a percentage of risk-based capital at 199%. This is in contrast to banks with assets over $250 billion, which have a lower CRE exposure at 54%. Banks will need to adapt to more challenging macroeconomic conditions in 2025: lower interest rates, modest economic growth, and credit cycle normalization. While the exact scenario is unclear, banks should be prepared to respond quickly to changes. Many banks may need to recalibrate their business models. Banks will need to get creative and think outside the box to boost their noninterest income, shed technical debt, and become more efficient with cost management. They should also prepare for the potential impact of the revised Basel III rules on their capital requirements. To strengthen their foundation for sustainable growth, banks could answer four key questions: 1. How might the revised Basel III rules affect the banking industry? 2. What steps can banks take in 2025 to increase their noninterest income? 3. Will the promise of AI-powered banking accelerate tech modernization, and if so, how? 4. Why are banks' efforts to manage costs typically unsustainable, and what should they do about it? In the following chapters, we'll delve deeper into these questions and offer guidance on how banks can prepare for 2025. The revised Basel III proposal suggests lower capital requirements than the original plan, but these rules have not yet been finalized. Banks are likely to continue reducing excess capital to optimize their balance sheets and engage in financial transactions to reduce their capital needs. The likelihood of bank mergers and acquisitions may increase among smaller banks with less than $250 billion in assets. Other countries are adopting their own Basel III requirements, which could impact bank competitiveness worldwide. The revised proposal would lower banks' capital requirements compared to the original plan, benefiting banks in general due to relaxed regulatory rules and reduced uncertainty. However, larger banks could still face stricter capital constraints. Federal Reserve Vice Chair Michael Barr outlined key changes to the original proposal, including a 9% increase in common equity tier 1 for global systemically important banks (GSIBs) and the retention of the tiering approach to regulation. Some important takeaways from the revised proposal include: * The removal of stricter standards known as "gold-plating," which were higher than those recommended by the Basel Committee. * Further changes are still possible after the Federal Reserve releases the rules, followed by a 60-day comment period. * The revisions are supposed to be jointly implemented with other regulatory agencies. Banks should take note of these developments and prepare for the potential implications on their business models. The banking industry is closely monitoring developments regarding the re-proposal of capital requirements by the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC), which have yet to vote on them. Some lawmakers are also exploring intervention through the Congressional Review Act. As banks prepare for new regulatory standards, they are optimizing their capital by redeeming preferred shares to reduce capital and boost return on equity. This move aims to improve financial performance amid increased lending competition from nonbank financial institutions. To adapt to growing private credit, banks are engaging in various financial arrangements to lower overall capital retention. The Basel III Endgame rules are expected to encourage more credit risk transfers (CRTs), particularly among larger banks with assets exceeding US$250 billion. Regional US banks have already explored CRT deals and forward-flow arrangements, which allow them to reduce risk-weighted assets and recycle capital more quickly. However, the re-proposal may have less impact on bank M&A across the industry than initially thought, as smaller banks are still likely to engage in dealmaking to achieve scale. Instead of reducing regulatory costs associated with becoming a large bank, these institutions might focus on diversifying their portfolios, expanding into new markets, and acquiring low-cost, stable deposits. Key message: To compensate for challenges in growing net interest income, banks should prioritize boosting noninterest income through targeted strategies. Banks are exploring innovative pricing strategies, such as bundling services and tiered accounts, to boost noninterest income. Payments sector is focusing on increasing transaction volumes through new channels and expanding value-added services. Wealth management is emphasizing personalized advice, enhancing customer experience, and revising fee structures. As interest income pressure is expected in 2025, banks may prioritize boosting noninterest income. This revenue stream has averaged 35% of total income for the US banking industry over the past decade, with minimal growth. Noninterest income products require minimal capital and are more profitable than interest-based businesses. Banks can grow noninterest income by increasing transaction volume, offering new services, or implementing new pricing strategies. These strategies may vary depending on business type, customer price sensitivity, and regulatory requirements. Looking ahead to 2025, banks should reevaluate their noninterest income strategies, particularly in retail banking, payments, wealth management, and investment banking. In retail banking, service charges like overdraft fees make up a significant portion of noninterest income. However, regulators are keen to limit these fees, making it essential for banks to develop new strategies. Options include adding services, bundling different services, tiering pricing based on account offerings, and developing finer customer segmentation using data like lifestyle or spending habits. To achieve this, banks must gain a deeper understanding of customer needs and price sensitivity, and equip themselves with robust customer data and targeted marketing capabilities. Payments companies in the US generate over $100 billion in fee income annually, according to Deloitte's analysis. A Federal Reserve study found that fees, excluding interchange fees, account for 15% of credit card issuers' total profitability. Payment networks, on the other hand, earn almost all their revenue from fees. However, this business faces challenges such as declining transaction margins and increased regulatory pressure on late fees. Merchants are also pushing back against interchange fees by incentivizing customers to use low-cost payment methods like point-of-sale account-to-account payments. To boost fee income, payments companies can increase transaction volumes by enabling seamless and secure transactions, and deliver more value-added services to merchants and customers. Card issuers can grow co-branded deals in new spend verticals and channels, such as in-app gaming purchases and social commerce. Working with merchants to enable secure payments and expand options via different instruments can also allow payments institutions to alleviate customer concerns and grow revenues. Additionally, offering value-added services like accounting services to small and midsize business clients can generate additional fee income. Payment networks can continue to grow their data and risk management solutions, as seen in Mastercard's 19% year-over-year growth in its value-added services and solutions vertical. In wealth management, banks have experienced significant growth driven by increased assets under management. However, there is still room for growth, with top banks only holding a 32% market share globally. Nevertheless, opportunities may be harder to exploit due to increasing competition, commoditization of advice, and customer dissatisfaction with fees. Regulators are also focusing on fee transparency, leading to calls for fee compression. The wealth management industry is shifting towards a more digital and client-centric approach, as seen in the Wealth and Asset Management 4.0 concept (figure 7). However, this evolution is not uniform across all areas, with passive investment strategies being one of the most conservative sectors. Clients are increasingly dissatisfied with fees, with only 36% expressing satisfaction with their current fee structures. To increase fee income, wealth management firms can focus on delivering value to clients through personalized advice and expanding services beyond traditional investments. In-person interactions and digital interfaces can help provide tailored advice, while also incorporating services like tax planning, estate planning, or long-term care. A recent survey by Deloitte found that many wealth chief investment officers are updating their platforms to integrate these additional services. Clients are willing to pay for advice, and firms should aim to exceed customer expectations through personalized experiences, resolving issues proactively, and streamlining the onboarding process. Modern technology architecture plays a crucial role in achieving this goal. Wealth managers can also offer more tailored products and services, such as alternative investments. Firms could benefit by incentivizing advisors to cross-sell other banking products, like loans and deposit accounts. Additionally, firms can explore revising pricing orthodoxies and redesigning fee structures to align with customer preferences. In the investment banking and capital markets sector, US banks' recent earnings show a resurgence in capital markets revenues due to increased mergers and acquisitions activity, greater demand for capital from companies and private equity sponsors, and elevated trading volumes. This positive outlook may continue into 2025 if market activity remains strong. However, capital markets firms may need to consider unconventional options to grow fee income. For instance, some banks are looking to capture a larger share of fees paid out when deals collapse due to regulatory challenges. Others are seeking higher fees for fairness opinions and targeting smaller deal sizes. Expanding into new geographic markets, both domestically and abroad, is another potential opportunity to drive growth. To stay competitive, banks should leverage private equity firms to access new funding opportunities. This is especially crucial given the significant amounts of "dry powder" these firms currently hold. Key takeaways for banks include: - **Accelerating Technology Modernization**: AI-powered banks can serve as catalysts for modernizing technology. - **Resolving Technical Debt**: Long-standing technical issues must be addressed to successfully deploy AI across organizations. - **Maximizing Cloud and Data Investments**: Upgrading cloud investments and data infrastructure should be a priority, alongside adopting traditional and generative AI. Banks need to make a conscious effort to capitalize on the power of artificial intelligence (AI). This means leveraging both traditional AI models and newer generative AI technology. Traditional AI can be used to improve business outcomes by utilizing predictive power, while generative AI can help create new content. Major banks like JPMorgan are already investing in these technologies, with some seeing significant results from their efforts. For instance, one solution implemented at JPMorgan led to a 10% to 20% increase in customers completing product applications. Even smaller community banks are starting to adopt AI tools, such as BAC Community Bank's app that uses AI to answer user questions and provide personalized support. As generative AI becomes more prevalent, we might see a shift from experimentation to widespread adoption across the banking industry by 2025. This could involve transitioning from closed-source models built in-house or supplied by tech vendors to open-source models using publicly available code. This change would give banks more control over their generative AI software and data exposure, which is crucial for those with limited technical budgets. To stay competitive, smaller banks might consider joining consortiums that share resources and best practices for developing an AI playbook. Furthermore, they could benefit from deploying small language models that are less expensive to build and maintain but still powerful enough to handle specific tasks. The banking industry's ability to modernize and strengthen its core is crucial for effectively embracing tech transformation. A recent survey found that nearly six out of ten banking leaders consider legacy infrastructure as the top challenge hindering their organization's growth. As a result, more than three-quarters of banks plan to increase investments in data management and cloud consumption by June 2024 to advance their enterprisewide generative AI strategy. By embracing this change, banks can unlock significant business potential and stay ahead in today's fast-paced technological landscape. The integration of Generative AI in enterprise settings has been surveyed, revealing the challenges of bringing outdated mainframe-based systems into the modern era. This process can be likened to an uphill battle due to the high costs and long timeframe required for full replacement. Some banks may feel constrained by their legacy technology, according to Acting Comptroller Michael J. Hsu. Others might hesitate to transition to newer core systems offered by less-proven providers. Despite progress made in modernizing cores, accelerating this pace is necessary to achieve the full potential of AI. Tools like Zions Bancorporation's decade-long incremental conversion process or wrapping legacy cores in a service layer interfacing with next-generation systems through APIs could be viable options. Generative AI might prove particularly valuable in upgrading legacy mainframes at scale by rewriting outdated code, assessing banking system states, preparing data for conversions, automating integration of microservices, and investing in cloud migration. A robust data infrastructure is essential for achieving the full promise of an AI-powered bank. Scaling cloud investments necessitates a targeted strategy that considers operational risks, timelines for software wind-downs, and optimal public versus private cloud mixes. Maximizing value from cloud requires considering economics through FinOps approaches to manage costs while maximizing return on investment. As cloud technology advances, banks are reevaluating their hybrid cloud strategies and weighing the costs against their overall IT spending. This shift has prompted cloud providers to offer AI solutions to appeal to banks, particularly smaller institutions. However, adopting these solutions requires careful consideration of potential vendor lock-in and the benefits of developing in-house AI models. In parallel, banks must address the state of their data infrastructure, which is often fragmented, complex, and difficult to access. To effectively deploy AI, institutions must upgrade their data systems by ensuring consistent availability, high quality, proper structuring, and alignment with project objectives. This may involve integrating data pipelines, bridging gaps between diverse sources, and using tools like ETL processes or Reverse ETL. In the context of cost management, banks face a pressing need to control expenses as revenue growth remains elusive. Fostering a cost-conscious culture can drive productivity, scalability, and resilience. Banks should focus on scaling AI and automation applications to reduce inefficiencies and integrate risk controls for sustainable cost reductions. Banks' expenses are unlikely to decrease significantly anytime soon due to steady growth in compensation, regulatory compliance costs, and technology investments. In the US, banks with over $10 billion in assets saw a 4.1% year-over-year increase in compensation expenses, reaching $149.6 billion in the first half of 2024, largely driven by performance-linked rewards in revenue-generating businesses. Conducting a thorough analysis of an enterprise's cost structure before implementing an expense management program is crucial to realizing savings by 2026. However, simply employing methods like activity-based costing (ABC) may not be enough. Cost transparency offers a unique perspective on why underlying costs are elevated, allowing banks to address inefficiencies that drive up expenses. For instance, senior bankers in the loan underwriting division might be taking on tasks outside their roles, making downstream actions more costly. When used together, cost transparency and ABC can help executives identify both the root causes and symptoms of high costs. This understanding allows them to make informed decisions about resource deployment and sustainable cost reduction. Finance executives, along with operational teams, are well-equipped for this task due to their expertise in modeling and access to organizational data. They can conduct surveys to gather metrics that can be cross-referenced in financial models, such as employee time spent on applications and purposes. This helps pinpoint areas where costs can be optimized without compromising productivity. Automating manual processes with AI and machine learning tools can free up resources for more valuable interactions, a strategy many banking executives are already exploring. According to Deloitte's survey, nearly half of the surveyed executives aim to boost productivity with generative AI, expecting added efficiencies to reduce costs. However, there is significant potential for further cost savings by scaling machine learning applications and integrating risk controls into transformation initiatives early on. By embedding risk and compliance into these early stages, banks can make cost reductions more sustainable and compliant with regulatory requirements. This includes steps like installing guardrails in AI model development for credit decisioning to mitigate risks of algorithmic bias and lack of transparency. Additionally, updating control frameworks to meet regulations provides opportunities to eliminate inefficiencies that raise labor and operating costs. A robust execution discipline is also key, fostering a cultural mindset around expense control that prioritizes efficiency without compromising quality or compliance. To achieve lasting improvement, cost-mapping models should be regularly updated as the bank undergoes changes or applications are acquired or sunsetted. This enables executives to monitor cost changes over time and understand their impact on performance outcomes. Strong execution discipline is crucial in preventing costs from rising again in the future. Continuous tracking of outcomes against business goals is essential to ensure the cost of transformation aligns with proposed budgets. Leaders should hold teams accountable for missing cost targets, even if they meet other milestones. The report addresses five critical questions that bank executives should prioritize in 2025. However, it's essential to recognize that other priorities, such as transitioning to a green economy and revamping talent models, will also demand attention. By taking decisive action now, banks can ensure a brighter, more resilient future. Strategic group mapping is a technique used in strategic management to analyze industry competition dynamics. It involves identifying key dimensions, plotting firms on a map, forming strategic groups, analyzing these groups, and understanding the implications for each company. By analyzing the strategic group map, companies can identify market gaps, areas of intense competition, and less contested spaces. This analysis also helps understand risk profiles and predict how competitive pressures will affect different groups. Strategic group mapping is a valuable tool for businesses to better comprehend their competitive environment. By identifying direct competitors, understanding the underlying structure of the industry, and pinpointing opportunities for differentiation or entering less competitive market spaces, firms can make informed decisions. The process involves several steps: first, identify key companies in your industry; second, select relevant strategic variables, such as price levels, quality, or geographic coverage; third, collect data on each company concerning those variables; fourth, choose axes for the map based on independent and effective variables that separate companies into distinct groups; fifth, plot each company on the two-dimensional map according to its position on the chosen variables; sixth, identify strategic groups formed by clusters of companies pursuing similar strategies or business models; seventh, analyze the dynamics within each group and between groups, including size, distance, and defining characteristics; and finally, draw strategic insights to inform your company's strategy. #### Creating accurate maps to reflect industry changes is key for businesses. Strategic Group Mapping isn't just about theoretical understanding but also provides practical tools for strategic planning and decision-making. It visually represents the competitive landscape, helping companies understand their position in relation to competitors. Strategic group mapping involves grouping companies based on specific strategic dimensions, providing a clear picture of market dynamics and company positions. This approach is useful across various industries: - **Automobile Industry:** Companies are grouped by focusing on luxury vehicles (LuxoMotors, EliteCars), economy cars (BudgetWheels, EconoDrive), or electric vehicles (EcoMovers, VoltRiders). - **Smartphone Industry:** High-end smartphones with advanced technology (InnovateX, TechFrontier) and budget-friendly smartphones with basic features (ValuePhone, BudgetComm). - **Retail Industry:** High-end retailers (AllNeeds Luxury, EliteChoice), discount retailers (BudgetBuy, EconoShop), or specialized retailers focusing on niche markets (TechHub for electronics, StyleAvenue for fashion). - **Airline Industry:** Premium airlines offering international long-haul flights (GlobalWings, SkyLux) and budget airlines focusing on domestic or short-haul routes (EconoFly, BudgetAir). - **Restaurant Industry:** Fast-food chains (QuickBite, SpeedyEat), fine-dining restaurants (GourmetFeast, EliteDine), and casual dining places (FamilyHub, RelaxedEatery). A strategic group map visually displays these groups based on selected variables. It helps understand competitive strategies within each group, the nature of competition, and barriers to moving between groups. Note that industry dynamics can be more complex in real-world scenarios with a greater variety of strategic variables. A Strategic Group Map Creator is a tool or software designed to help create such maps, providing a practical method for businesses to adapt to changing market conditions and make informed strategic decisions. Strategic Management and Business Analysis Tools Offer Visual Insights Into Industry Competitiveness These tools help organizations visualize competitive positions of different firms within an industry based on selected strategic dimensions.